

OPTIONS FOR ENHANCING MONTANA'S BUDGET PROCESS

A Report Prepared for the

Legislative Finance Committee

By
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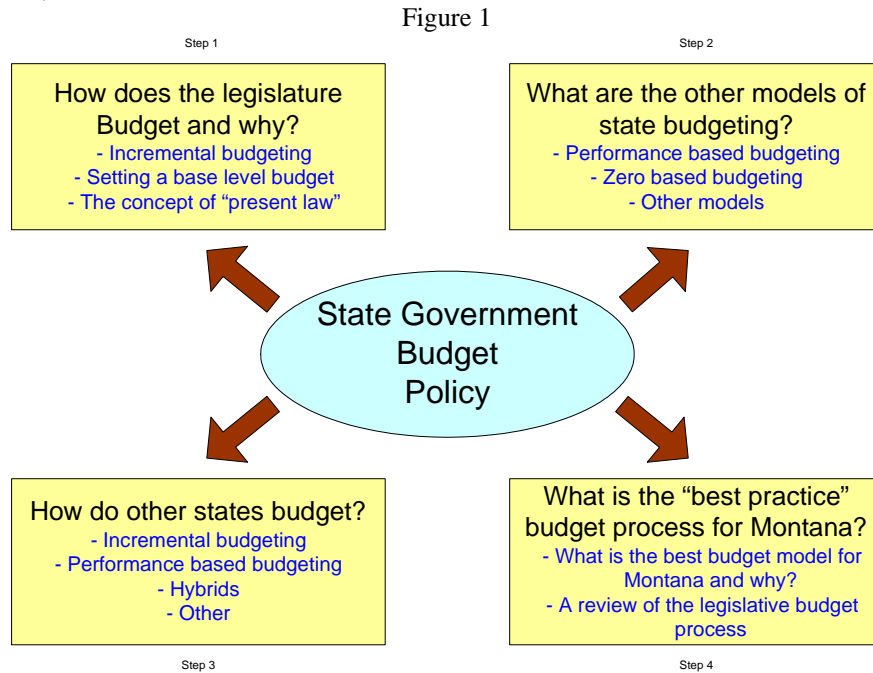
Legislative Fiscal Division



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INTRODUCTION

At the June 2003 meeting of the Legislative Finance Committee (LFC), a work plan item was approved that amounted to a study of the state budget process, including a look at what other approaches are available and what other states are doing. The structure of this study is represented by the following illustration (Figure 1).



In October of 2003, Legislative Fiscal Division staff presented a report to the LFC that covered the first three steps of this study. It explored the primary approaches to budgeting that are applied by the various states, and discussed in some detail the approach currently used by the State of Montana. A copy of the first report is attached (Attachment A) for your review, since it has been a year since it was first presented.

In that report, it was pointed out that there are four especially notable approaches to budgeting that the various states apply in one form or another. They are: 1) traditional/incremental budgeting; 2) program-based budgeting; 3) performance-based budgeting; and 4) zero-based budgeting. Montana predominantly uses the traditional/incremental approach, as do a large majority of the states. Most of these states, including Montana, have incorporated features of the other approaches in an attempt to take advantage of some of the benefits of those methods of budgeting without the drawbacks. Some states have made one or more of the other budgeting approaches their predominant approach, but they too have incorporated features from others. It appears that no state has wanted to implement any of the four approaches in its purest form. The evolution of budget systems in the various states seems to illustrate that hybrids of the budget models have the best success stories, and that state budget systems continue to evolve based upon the fiscal condition and the political climate in which they exist.

The initial report also pointed out that the "traditional/incremental approach" is favored by most states because of the flexibility that it allows and because it is the least cumbersome of the approaches.

This report takes on the fourth and final step, a discussion of the issues that might lead to a better budgeting process for Montana.

PURPOSE OF THIS REPORT

The purpose of this report is to ascertain if the LFC has an interest in proposing changes to the budget process for future biennia. It is not likely that significant changes can occur for the upcoming session, primarily because of the fact that the current process is driven by statute that might need modification. Also, by the date of this report, the executive and legislative staff will be well into the development of the budget for the 2007 biennium. For future biennia, how can the legislature enhance the budget process while addressing long-standing concerns?

WHAT IS MOST IMPORTANT?

The options seem limitless when you think about all the iterations possible for a state budget process, given the potential for hybrids that use the best features of the several approaches currently used by the many states. Therefore, this report will focus on some key elements of budget approaches that are used around the country and focus the discussion on topics that seem most important based upon the questions and comments of LFC members when the first report was presented and upon the history of such discussions over the years.

COMMENTS FROM THE COMMITTEE

The discussion following the original report was brief, but comments from individual members can be summarized as follows:

- Support was expressed for the “incremental” approach that Montana currently uses...HB 19 of 2003 legislative session was an attempt to solve some problems, with a change to the existing ineffective expenditure limitation and the addition of a rainy day fund
- Growth in the budget should be viewed as a “con” of the incremental approach
- There was a suggestion to reduce the base to the level of revenues available (similar to the rollback of last session) because the incremental approach assumes growing resources...inherent in this point is the relationship between revenues and expenditures
- There was also a statement that the state does not need to spend all the revenue it receives
- There was an expression of frustration with the lack of detail and discussion with regard to the statewide present law adjustments
- The process should be about deciding what we need...looking at underlying assumptions of the budget

The comments indicate a degree of satisfaction with the incremental process but also a desire to review base budgets, at least in a manageable way. Concerns for budget growth should be addressed in some fashion, by understanding the nature of the growth and/or figuring out how to control the certain growth drivers. Given this conclusion, the incremental process can be retained but with some enhancements that help legislators understand what state government does, why it is done, and what changes the legislature might make in state policy to: 1) improve the delivery of state government services, and 2) control the growth of the budget. The implications are performance reviews and exploring the base budget to a greater degree. In addition, present law adjustments need to be better understood.

WHAT IS THE VALUE OF THE LEGISLATURE REVIEWING STATE GOVERNMENT PERFORMANCE?

Reviewing performance requires a look at the whole program, not just the incremental increases that are proposed for the new budget period. This process would open up the base budget for review as it forces the legislature into discussion that relates more to the policy behind the program rather than focusing on number of FTE or how much they spend in contracted services, travel, or rent. It can lead to policy-oriented questions like:

- Does the state receive the best value in services provided by this program versus other programs?
- Does this program produce results consistent with the intent of the statute that creates it?
- What might the legislature do in setting policy to improve the outcomes of the program?

The answers to these types of questions provide the legislature with a basis for retaining, changing, or eliminating certain policies and programs. Attachment B is taken from a recent NCSL publication titled *Legislating for Results* and lists some benefits of using performance information.

A key element of performance-based reviews is the need for training of legislators and reviews of agency programs during the interim from which thoughtful feedback is obtained. The legislature needs to make a commitment to participate in this way. Otherwise, the work that agencies put into developing performance data for the budget process is for naught.

HOW DEEP INTO THE BASE BUDGET WOULD THE LEGISLATURE WANT TO GO?

The depth of any analysis of the base budget would depend almost wholly on staff resources and the legislature's willingness to embrace the process and invest the time and energy needed to thoroughly review the volume of data that it can entail. But it also depends on the quality of information that agencies are required or willing to provide. The investment of time and resources can be significant on every front...the Executive Branch agencies, the Governor's Office of Budget and Program Planning, the Legislative Fiscal Division, and the Legislature. The design of a budget process that encourages the more thorough base budget review must take this into account.

To deal with this factor, the legislature might approach it in parts; i.e., taking on only a few agencies or programs each session (or interim), or taking on only a portion of the base, such as occurs in a small way with the requirement in statute that the agencies provide, with their budget submission, a plan to reduce their budget by 5 percent (17-7-111(f), MCA). There is also the possibility of carving out one or two key policy areas, that might even cross agency lines, and focus a budget base review on those areas.

The 2003 legislature attacked the base in another way. Early in the session, the joint House Appropriations and Senate Finance and Claims Committees adopted a rollback of the base because of the severe revenue shortfall. Agencies were forced to argue for the restoration of the rollback in each appropriations subcommittee, although not developing the budget from this revised base created extensive confusion. In the end, almost all of the agencies had their base restored. Such a mechanism could be statutorily built into the Governor's budget submission requirement in the form of a modified zero-based approach.

During the current interim, LFD staff has spent considerable time developing tools and products to provide a better understanding of what state government does and what is in the base. This will better enable staff to assist the legislature in an evolution to increased reviews of base budgets.

HOW CAN THE LEGISLATURE BE MORE INFORMED REGARDING “PRESENT LAW”?

“Present law” adjustments are the difference between the “base budget” and the “present law base”, both of which are defined in 17-7-102, MCA, as follows:

(4) "Base budget" means the resources for the operation of state government that are of an ongoing and nonextraordinary nature in the current biennium. The base budget for the state general fund and state special revenue funds may not exceed that level of funding authorized by the previous legislature.

(10) "Present law base" means that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature, including but not limited to:

- (a) changes resulting from legally mandated workload, caseload, or enrollment increases or decreases;*
- (b) changes in funding requirements resulting from constitutional or statutory schedules or formulas;*
- (c) inflationary or deflationary adjustments; and*
- (d) elimination of nonrecurring appropriations.*

The Legislative Fiscal Division (LFD) groups the adjustments into two groups: 1) statewide present law adjustments, and 2) other present law adjustments. Statewide adjustments affect all or most state agencies. The other adjustments are usually unique to specific programs and are addressed as individual decision packages within the context of the appropriate agency and program.

Generally, the concern that is expressed the most is that the “statewide present law” adjustments do not get the scrutiny by the legislature that they should. The concern relates primarily to items (b) and (c) above. These adjustments include:

- personal services adjustments that are a product of the method of funding personal services;
- inflation/deflation factors that are determined as appropriate for select types of expenditures;
- fixed costs adjustments as determined by the executive and reviewed by the appropriate joint appropriations subcommittees; and
- vacancy savings adjustments that have become a traditional budget tool used to account for the fact that vacancies do occur.

At the beginning of a legislative session, the statewide present law adjustments are presented for approval, in a package of what are referred to as “global” issues, to a joint meeting of the House Appropriations Committee and Senate Finance and Claims Committee. The reason these budget issues have been handled in this way is to ensure consistency. If these decisions were made at the subcommittee level, the potential is there for subcommittees to make different decisions, resulting in agencies being treated differently. For example, an inflation adjustment for energy costs might be allowed for one agency but not for another. The fact that these are “present law” adjustments indicates that either a previous legislature enacted something that causes the adjustment (such as a delayed pay plan implementation), or there is a need to acknowledge that the cost to provide the same level of government service has increased for the provider for the government service (such as the cost of natural gas). As a way to establish a little more control over statewide present law, the executive budget and legislative budget analysis could in some instances separate some decisions related to fixed cost rates from the statewide items, showing them as separate decision packages for legislative consideration.

The question is whether there is a better way for the legislature to review and make decisions on the statewide items -- not to necessarily increase the opportunity to cut or disapprove the items, but rather to make sure that all involved understand them. These statewide items are developed within context of the statutes that govern the development of the budget. The LFD is given little discretion for determining

and presenting the present law budget, although there are occasional disagreements between the LFD and the Office of Budget and Program Planning (OBPP) as to what constitutes “present law.” Any change to the statutory definition of present law must be done along with addressing the underlying reasons for identifying a present law base.

BESIDES A “BALANCED BUDGET” REQUIREMENT, WHAT IS THE RELATIONSHIP BETWEEN REVENUES AND THE BUDGET?

“Structural balance” is often discussed in the context of the budget. This is achieved when ongoing state expenditures do not exceed ongoing state revenues. The risk to structural balance is the dependence of the state on one-time revenues (revenues that are not ongoing) to fund new or existing programs of state government. For example, through the 1990’s, states experienced significant growth in individual income tax revenues, driven to a large degree by a surge in capital gains. States did not look at this surge in revenue as a short-term phenomenon and allowed expenditures to grow in similar ways or in some instances reduced taxes. When revenues dropped beginning in fiscal 2002, almost every state was faced with budget crises of significant proportions, and for the past few years, budget cuts and revenue enhancement measures have dominated the states’ budget picture.

Finding a way to stabilize state revenues and control budget growth is an important consideration for any state legislature. Here are a few concepts to discuss:

- The focus on “available” revenue could change. The legislature could somehow fence off revenue that is determined to be “one-time” in nature (meaning sources that cannot be sustained) and only use “ongoing” revenue to fund the budget. One-time revenues could be used to fund “one-time” expenditures. In this way, budgets would not be built with a dependence upon revenues that are not sustainable. Certainly the difficulty would be in identifying, in some instances, revenues that are not sustainable. For example, it might be difficult to determine a sustainable level of individual income tax revenue when capital gains can be so volatile.
- An “expenditure limitation” provision can be a tool to help maintain a structural balance. By limiting the growth in expenditures each year, expenditures can be kept from increasing with revenue growth when it grows at extraordinary rates, thereby not letting expenditure levels increase to levels that cannot be sustained.
- A “rainy day fund” can provide at least short-term stability for funding the budget. Many states have had rainy day funds, which to some degree helped them through the recent budget crisis. Some states maintain a reserve of up to 10 percent of their budget for this purpose. These funds can provide a buffer against the unexpected downturn in revenues and reduce the need for the most severe budget reductions. While not exactly a tool for attaining structural balance, it can mitigate the consequences of not maintaining a structural balance.

OTHER CONSIDERATIONS

LAW CHANGES

Depending upon the changes to the budget process that the committee might wish to pursue, changes to statute might be necessary to implement the changes. A bill would need to be drafted, a sponsor identified, and speaking points prepared.

SYSTEM CHANGES

Depending upon the changes to the budget process that the committee might wish to pursue, changes to the state's budgeting system (MBARS) might be necessary. Such changes would have a cost that might or might not be absorbed within existing funding levels for maintenance of MBARS.

LEGISLATURE'S CAPACITY

A move to either a zero-based or performance-based budgeting approach would most certainly add workload to legislators who participate in the budget review process. Both of these budgeting approaches, or even hybrids of them, involve the development and publishing of considerably more data to be reviewed. The legislature should be aware of the need to commit more time to the budget process. There would also be a learning curve for legislators as the state transitions to a different approach. The difficulty that some states have encountered with these types of budgeting approaches is that legislators have not embraced the change and have not been willing or able to give it additional time. Even instances in which a few agencies have "piloted" such approaches, the legislature has not used the product, which is why these approaches have not taken root.

STAFF RESOURCES

Agency staff and management, Office of Budget and Program Planning staff, and legislative staff would have significantly increased workload relative to the budget process if a zero-based or performance-based budgeting approach were adopted. Depending upon the nature of the approach adopted, there might be additional requests for staff and other resources to comply with any increase in workload expected from the requirements of the approach.

OPTIONS

The following are various options that the committee might consider:

1. Develop a strategy for bringing better performance review into the Montana budget process, without the negative workload impacts that are typical in performance-based budgeting.
 - a. Increase the emphasis placed on the performance of each state program by requiring agencies to develop performance information, and then encouraging appropriation subcommittees to base their budget decisions more on the performance factors...vision, mission, goals and objectives, and performance indicators and measurements. Within the agencies, it is presumed that budgets are developed in concert with the agencies' planning activities. There needs to be a mechanism for carrying that forward to the legislature so that the legislature can review it's policies as expressed in statute in relation to goals/objectives of the agency and the results the agency achieves. Key to this approach is getting buy-in from the legislature that the information developed and the strategy adopted will be used. In order to secure buy-in, an interim legislative committee could develop this strategy.
 - b. Identify one or two major policy areas for a focus on performance of programs within those areas to review base programs, their relevance to current state policy, and the relevance of the budgets to that policy.
2. Recommend that the legislature review its requirement that each agency provide with their budget request, a plan for reducing the base budget by 5 percent. The legislature could consider incorporating the plan into the agency's base budget request as a form of zero-based budgeting, requiring the reduction in the base budget submission, and requiring agencies to justify the reinstatement of the 5 percent portion as a present law adjustment or new proposal.

The intent would be to force a policy discussion of at least the portion of the budget represented by the 5 percent base reduction. Presumably, the 5 percent portion would represent a lower priority portion of the agency's base budget.

3. Request that staff develop a more detailed explanation of the content of statewide present law adjustments. The purpose would be to better educate the legislature. Agencies could be required to provide the more detailed explanation for each program to provide a basis for the data needed for the legislature. The primary part of this would relate to personal services, and showing what contributes to the adjustment amount, i.e., pay plan annualization, reclassifications, promotions, etc.

STATE BUDGET PROCESS

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By
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September 19, 2003

Legislative Fiscal Division



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Attachment A

STATE BUDGET PROCESS

INTRODUCTION

There are oftentimes concerns expressed about whether the approach to budgeting in Montana is working. Does it provide the best product for the legislature in its deliberations and the citizens in terms of funding programs and services? Does the approach foster the types of program review and budget debate that would result in the best budget? The concerns have resulted in the addition, to the LFD workplan, of a review of the state budget process relative to the budget approaches that are available. The information provided here is intended to offer a foundation for that discussion.

The purpose of this report is to examine the state budgeting practices of Montana and other states, and to provide the Legislative Finance Committee, the legislature, and other interested parties a better understanding of the Montana process and methodologies that are applied in state budgeting agencies around the country. This report begins with a description of the budgeting models that are available and used to some degree in various entities. It is followed by a description of the Montana budget process and methodologies. The third part is a review of budget methodologies used in other states. Montana has at one time or another incorporated features of various approaches into its budget process. These variations are discussed later in the report. This report includes one attachment (Appendix A), which is an excerpt from a publication titled *Fundamentals of Sound State Budgeting Practices* that was issued by the National Conference of State Legislatures and the Foundation for State Legislatures in May, 1995. It offers a discussion of some of the same concerns that are heard concerning the Montana budget approach and explains why the traditional/incremental budget process continues to be the most predominant approach used among the states.

WHAT ARE THE MODELS FOR STATE BUDGETING?

Incremental Budgeting

Incremental budgeting is a method of budgeting that begins with a previous period budget (or expenditures from a previous period) as the base budget, with the budget being further defined by increases or decreases based upon various relevant factors (e.g., inflation, caseload adjustments, etc.). As defined by the National Association of State Budget Officers (NASBO), incremental budgeting requires that only additions or deletions to current budgeted expenditures be explained and justified. Funding decisions are made on the margin, based on the justification for the increased or decreased costs of operating agencies or programs, or the desire to add or expand programs (or eliminate or reduce programs). A review of the base appropriations is not precluded; however, it is not an integral part of this budget approach either.

Pros:

- Least complex and more flexible than the other models
- Provides an “adequate rationale” for decision making
- Focuses the decision making process on new proposed programs and some targeted or even unspecified (across-the-board) cutbacks, thereby giving some flexibility to the policy makers by allowing them to pick and choose the issues that are important to them
- It allows, but does not require, policy makers to use techniques that are associated with other budgeting approaches, such as use of performance measures or appropriation by program

Cons:

- Does not typically require an examination of the base budget, only the adjustments to the base (present law adjustments) and new proposals
- Does not provide a linkage between budgets and outcomes from base expenditures, which can also make it difficult to evaluate present law adjustments
- Typically does not encourage policy judgements beyond the marginal changes

Program-Based Budgeting

Program budgeting provides for a focus on the structure of government, by grouping like functions together within an agency, thus facilitating decision making by both the executive and the legislature. It has evolved over time from a simpler organization of functions, to a more complex planning, implementing, and measuring model, which logically moved the program budgeting approach in the direction of the “performance-based budgeting” approach, which might explain why in many respects they are hard to tell apart. Today, program budgeting is a method that manages financial resources based upon identifying and prioritizing goals and objectives, and providing funds to the programs which best support goals and objectives that are embraced by the policy makers. It starts with a definition of the activities, functions, and ultimately the programs of government. Then goals and objectives must be identified. Finally, a means of measuring the outputs and outcomes relative to the goals and objectives is necessary. While the focus of this budgeting method is on determining the goals and objectives that are to be achieved, the ability to measure success for a program is important too. Measurements of the achievements of the programs are critical to the effectiveness of this budgeting method. This method allows some flexibility in expenditures as long as the objectives remain the focus.

Pros:

- Agencies describe through goals and objectives what they would propose to do...it allows good communication to staff and citizens by making goals and objectives visible, and it allows an opportunity for program review by the legislature
- More flexibility for agencies as appropriations are typically made as “lump sum” appropriations
- Agencies more likely to be held accountable for meeting goals and objectives rather than for expenditures from detailed expenditure categories
- There is an emphasis on performance and ultimate outcomes instead of on outputs (numbers served or items produced) and processes

Cons:

- Cumbersome planning activities...determining meaningful goals and objectives is a difficult task
- Developing, implementing, and tracking measurements can be difficult, oftentimes requiring creation of data systems to aid in the tracking
- Because of the flexibility that this method offers to the agency, there is some reduced control for the legislature...and concern for lack of accountability as the approach is not quite as rigid as performance-based budgeting
- Requires substantial resources (e.g., FTE, data systems)
- Much of the information generated tends to go unused because of the limited time for policy makers’ review

Performance-Based Budgeting

Although similar to program budgeting, performance-based budgeting is a method in which a budget is developed by program with the focus, however, being on program outcomes, and the measurement of

the program ability to meet the goals and objectives either in the short term or the long term. As with program budgeting, the process includes the setting of goals and objectives, but also involves the development of strategies for meeting the objectives, including design of measurements of performance. Cost benefit analyses play a role in assessing outcomes as well. It is the emphasis on outcomes that differentiates “performance-based” from “program-based” budgeting, which emphasizes the goals and objectives. The performance budgeting methodology establishes a budget at the level of service that policy makers determine to be appropriate, but based upon a comprehensive planning process that can include the customer (citizen or public in the case of government). It is intended to clearly state what is to be accomplished and at what cost. Hence, once the budget is approved, there is less flexibility in performance budgeting because once it is determined what is to be accomplished, the expenditures must occur to that end. Performance-based budgeting is different from program-based budgeting in a couple of ways: 1) it focuses on outputs and outcomes rather than the goals and objectives; and 2) it lends itself better to the input of citizens because it is easier to portray the expectations of results of funding provided.

Pros:

- Ties policy-making and budgeting together
- Allows citizen input
- Emphasis on getting most service for the dollar
- This process makes clear what is to be accomplished and how much it will cost
- Agencies would report on outputs and outcomes, *theoretically* achieving more accountability

Cons:

- It is difficult to get state officials/agencies and the legislature to embrace the significant workload that must occur for this budgeting approach
- Requires a substantial planning effort, including the determination of effective measurements of performance for each agency
- States have had difficulty tying performance to budget
- There is a need for significantly increased staff and systems resources to carry out this method of budgeting at all levels: agency, budget office, and legislative staff
- Much of the information generated tends to go unused because of the limited time for policy makers’ review
- Because of a more formal citizen involvement, this method is the most cumbersome
- If goals and objectives are not carefully determined, bad outcomes can occur
- In tough budget years, many states have not used the data to reduce budgets

Zero-Based Budgeting

Zero-based budgeting is a method of budgeting that starts with a base at “zero” dollars, and determines from scratch, based upon expected revenues and expenditure needs, the budget for the upcoming period. It requires all programs, activities, and expenditures at the base level, to be subject to justification (as opposed to incremental budgeting which typically does not). The requests for funding (decision packages) are usually ranked in order of priority, oftentimes demonstrating the alternative service levels that policy-makers might choose.

Pros:

- It requires analysis and consideration of the base budget as well as any new proposals
- Potentially allows the most thorough budget review of all approaches considered

Cons:

- Although it is a good idea to justify the whole budget each biennium, in reality it is cumbersome and time-consuming
- Supporting documentation can generate unworkable volumes of data
- Inconsistency in information provided by agencies has historically shown little value in this method...primarily because agencies have tended to put highly political programs on the list of low priority expenditures, knowing the political environment would pressure the legislature into funding the program
- This approach has rarely succeeded in its purest form...that of starting at zero

In some instances, states have applied the zero-based budgeting approach to select agencies each budget period. Over a period of years, all or most agencies could be subjected to this approach.

Another variation of zero-based is the concept of having agencies prepare a prioritized list of potential low priority items that add up to a given percent (say 10 percent) of the budget. It answers the question of what would be cut if the budget were funded at say 90 percent of the base. The legislature could then consider the list in budget deliberations, measuring these items against available revenues and relative to other budget proposals. HB 64 of the 1999 session put such a mechanism in statute at 15 percent. The 2001 legislature reduced it to 5 percent. This is currently at 17-7-111(3)(f), MCA. Regardless of the percentage, from the Legislative Fiscal Division perspective, neither agencies nor the legislature's budget deliberations have taken this component of the budget very seriously, and it has not come into play in establishing the final budget of the last two biennia. However, the Office of Budget and Program Planning (OBPP) points out that the reduction plans prepared by the agencies under this provision were used by OBPP in preparing the governor's reductions under 17-7-140, MCA, and the Executive Budget recommendations for the August 2002 Special Session.

Other Models

Line-item Budgeting

A line-item budget is developed based upon an intended specific use of the funds. The focus is on what is to be purchased with the funds. Appropriations to programs within departments are established as separate line items for each major category, e.g., personal services, operating, and equipment. Sometimes, however, the line item can be more specific, such as for a specific service or project. The Department of Public Health and Human Services budget has some good example of line items by service. Line item budgeting is common among the states and is oftentimes used in conjunction other methodologies. Line item budgeting results in stricter budget control but can limit agency flexibility that might encourage good management and creative results.

Formula-based Budgeting

This method refers to budgets that are based upon some predetermined formula, which may or may not be expressed in statute or rule at the state or federal level. In Montana, examples abound, with the most notable being the funding of education. In this example, funding is based upon student counts and an estimated average cost per student.

Responsibility-centered Budgeting

Under this methodology, a work unit (program or activity) is financially responsible for activities and is held responsible for expenditures, not unlike other methodologies. However, the difference comes from how a year-end surplus is handled. If an agency has a surplus at the end of the fiscal year, it can carry it forward to the next, so there is the incentive to be frugal, particularly if there is a large expense pending in the future year. If the agency overspends in a given year, the deficit must be made up in the next year, meaning that it would have a reduced amount available for expenses of the next year. This has some similarity to the “biennial” designation on a line item in the Montana appropriation bill.

HOW DOES MONTANA BUDGET AND WHY?

The primary methodology used by the State of Montana is “incremental budgeting”. This method is considered the “traditional approach” to budgeting as it dominates other approaches in most states. Montana has used this method of budgeting for many years, with occasional excursions into other approaches. Montana incorporates elements of zero-based, program, and performance-based budgeting into its approach as will be discussed later. First, the report will focus on the primary approach.

Incremental Budgeting in Montana

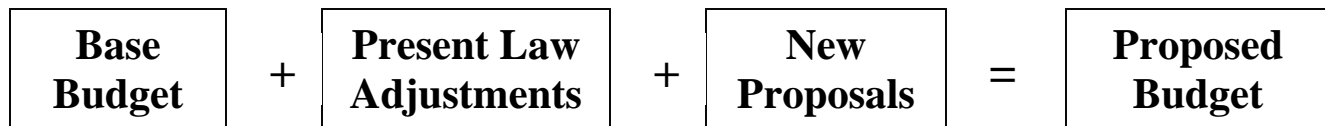
Montana adopted this approach many years ago. Montana’s legislature only meets 90 days every two years, leaving policy makers little time to regularly examine the base budget. Limitations on resources may have resulted in most states, including Montana, steering away from high maintenance budget approaches. Staff can perform such analyses to the extent that time allows (depending upon what other assignments they are given during an interim). Legislative staff oftentimes raise issues that, among other things, result from the analysis of the budget request, an agency’s request, a constituency complaint, or an individual legislator’s desire to find a source of funds for a new program. These issues can lead to a closer look at base programs, but these are the exception rather than the rule. OBPP staff spend time looking at base programs during the interim and Executive Planning Process.

Montana, in 1993, adopted a structure that provides for the state budget to be developed in steps: 1) “the base”, 2) present law adjustments, and 3) new proposals. These terms are defined in 17-7-102, MCA as follows:

- "Base budget" means the resources for the operation of state government that are of an ongoing and nonextraordinary nature in the current biennium. The base budget may not exceed that level of funding authorized by the previous legislature.
- "Present law base" means that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature, including but not limited to: (a) changes resulting from legally mandated workload, caseload, or enrollment increases or decreases; (b) changes in funding requirements resulting from constitutional or statutory schedules or formulas; (c) inflationary or deflationary adjustments; and (d) elimination of nonrecurring appropriations.
- "New proposals" means requests to provide new nonmandated services, to change program services, to eliminate existing services, or to change sources of funding. For purposes of establishing the present law base, the distinction between new proposals and the adjustments to the base budget to develop the present law base is to be determined by the existence of constitutional or statutory requirements for the proposed expenditure. Any proposed increase or decrease that is not based on those requirements is considered a new proposal.

Attachment A

The purpose of these steps is to show the legislature the components that make up the budget, starting first with the level of expenditures actually approved by the previous legislature, and then incremental increases and decreases that should, by statutory definition, occur to that base because of inflationary growth, caseload increases and decreases, etc., to fund the base at the level of services authorized by the last legislature. The last part shows the new initiatives the legislature is to consider. The present law adjustments and new proposals are reflected in the budget proposal as “decision packages” (requested changes to the base), which the legislature can approve, revise, or not approve. The following is a graphic representation of this approach.



This format is used in the budget proposed each biennium by the executive and throughout the legislative process. In addition, for each agency and program, the budget is also broken down by first level expenditures, i.e., personal services, operating, equipment, local assistance, grants, benefits and claims, transfers, and debt service, to the extent that these are used for any given agency. In addition, there is a breakout by funding source, i.e., general fund, state special revenue, federal funds, capital projects funds, proprietary funds, and nonexpendable trust funds,

Setting a Base Level Budget

The base is determined as expenditures for the most recently completed fiscal year, e.g., the base year for the 2004-05 biennium budget, considered and adopted by the 2003 legislature, was fiscal 2002. The base is the expenditures of that fiscal year, after adjustments such as the removal of one-time expenditures (expenditures that are not intended to reoccur). At the beginning of the 2003 session, in a departure from the norm, the legislature voted to “roll the base back” from the fiscal 2002 level to the fiscal 2000 level, requiring each appropriations subcommittee to approve decision packages in order to restore that amount back into the agencies’ budgets.

The Concept of Present Law

When the 1993 legislature adopted the current structure, it was trying to deal with misperceptions of what the budget represented. Previously, the base was a combination of the base budget and the present law adjustments. Legislators expressed concerns about the base budget being adjusted without their review and approval of the adjustments. They wanted it presented in a way that reflected how much they approved for the previous budget (that was actually spent) and how much needed to be added to the base budget due to inflation, caseload increases, annualization of the previously approved pay plan, etc., to fund the same level of services and operations, as the definition states.

The present law concept also provides another benefit. It allows the budget to show the distinction between the amounts needed for the adjustments to the base and for new proposals. It also allows the legislature to examine requested adjustments to the budgets by determination of what constitutes a change necessary or desired because of decisions already made and currently in place, versus changes desired to implement new programs or a change in direction, or because of changing financial circumstances (e.g., loss of revenues). As such, the legislature can determine whether underlying and current decisions, policies, or statutes must be changed in order to avoid or reduce the requested adjustment, or whether the decision is significantly more discretionary. The distinction between these two components of the budget is not always crystal clear.

Other Approaches Used by Montana

Although Montana primarily applies the most traditional of the approaches to budgeting, it also has incorporated other approaches or experimented with other approaches over the years. Characteristics of some of these approaches are still present in the current budget process.

Program budgeting is one approach that can be gleaned from an examination of the Montana process. It is most noticeable in HB 2, where appropriations are largely made at the program level, even though the budget is constructed at a detailed expenditure level. However, statutes and sometimes HB 2 contain spending rules that further control expenditures from the program level appropriations. HB 2 passed by the 2003 legislature contains less of such controls, giving the agencies additional flexibility in spending appropriations. The legislature chose to provide the additional flexibility so that the agencies could more easily deal with the “unspecified” budget reductions that were imposed. Also consistent with program budgeting is a requirement in 17-7-111(3)(c), MCA, for agencies to establish goals and objectives, although these are not as closely tied to the budget process as program budgeting would suggest. There are some agencies or programs in Montana government that effectively apply the development of goals and objectives, and measurements, to their management processes, but the legislature has not often embraced the significance of goal setting and measurements in the budget process, the issue most likely being time.

Performance budgeting has been explored in Montana in pilot efforts implemented in several agencies. Under authorization by the 1993 legislature, the Governor’s Office of Budget and Program Planning (OBPP) submitted performance-based budgets for three programs to the 1995 legislature. It appears that the 1997 legislature considered an additional 13 programs, but did not recommend the addition of any more programs to this budgeting approach. A discussion in a December 1997 Legislative Finance Committee meeting indicated discontent with the performance-based budget presentation in the budget and that it was not being used in subcommittees. Another comment was that the goals and objectives were “nebulous” and of little value to the process. The discussion fell just short of recommending discontinuation of the pilot project. Subsequent legislatures have not embraced the performance approach and it has since been abandoned.

Zero-based budgeting was applied in a modified form in Montana for a period in the 1970’s. Adopted by the 1975 legislature, it appears to have been applied to seven agencies for the 1977 session and nine agencies for the 1979 session. Most of the provisions were repealed in the 1979 session. It was found to be too complex and time consuming for the benefits gained. Since then, it has been applied only for certain types of expenditures. Capital budgets (long-range planning) have typically been “zero-based” in nature and continue to be. Some personal services costs like per diem for boards and advisory councils, overtime, inmate pay, and differential pay are still zero-based. In the past, expenditure categories such as equipment and contracted services were developed under a zero-based approach, meaning that the starting point would be zero, and any amount requested for the category would have to be explained and justified. Although this approach was not used in the last budget cycle (for the 2003 session), budget analysts still looked at such items to determine if expenditures should be excluded from the base for some reason.

HOW DO OTHER STATES BUDGET?

The table on page 9 is a state-by-state comparison of budget approaches. The source for this comparison began with one last updated by the National Conference of State Legislatures (NCSL) in 1999 and one prepared by the National Association of State Budget Officers (NASBO) in 2002. The NCSL table showed the “predominate” budget approach of each state and the NASBO table showed the various

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approaches a state applies. The tables were sent by e-mail to a legislative staff contact in each state for confirmation of the current approach in each state. Responses were received from 38 of the 50 states. Most states use multiple approaches, as does Montana. However, the budget approach that any given state applies is most likely a hybrid of the “theoretical” models described above. For example, a state might use the traditional, incremental approach primarily, but with variations that incorporate characteristics that resemble program budgeting or zero-based budgeting. Montana applies an incremental approach, but has incorporated features of program budgeting, zero-based budgeting, and performance-based budgeting.

It is important to note that this comparison is difficult to verify, as there seems to be differences in how various players view their state’s approach. This can occur for a various reasons:

- If the budget process starts and finishes in different agencies (like in Montana where the Governor’s budget office prepares a proposal and the legislature approves it), each office might take a different approach. For example, the executive may start with a traditional approach while the legislature reviews and approves the budget under a modified zero-based budgeting approach.
- There are many instances in which states have adopted hybrid approaches, and one person might view the state’s approach in one way and another person views it as another approach. For example, if a state operates a traditional incremental approach but incorporates goals and objectives and performance measures, one person could see it as an incremental approach and another person might view it as performance-based budgeting.
- Regardless of the varied perceptions, and contrary to what is shown for six states in the table below, the reality is that probably every state uses incremental budgeting to a large degree in their budget approach. This conclusion is from a discussion with two of those six states (Iowa and New Mexico).
- Although an approach is established as policy, it is not always clearly tied to the budget process.

In the pages immediately following the table are notes regarding each state, which are comments that were received in a survey of states or that were part of the original NCSL or NASBO compilations.

Budgeting Approaches of the States				
State	Traditional Incremental	Program Budgeting	Performance Budgeting	Zero-Based Budgeting
Alabama	x	X		
Alaska	X		x	x
Arizona	X	x		
Arkansas	X		x	
California	X	x		x
Colorado			x	x
Connecticut	X	x		
Delaware	x	x	x	x
Florida	X	x	x	x
Georgia	x	X		x
Hawaii	x	X	x	
Idaho	x	X	x	x
Illinois	X	x		
Indiana	X			
Iowa		x		X
Kansas	X	x		
Kentucky	X	x	x	
Louisiana		x	X	
Maine	x	x	X	
Maryland		X	x	
Massachusetts	x	x		x
Michigan	X			
Minnesota	X	x	x	
Mississippi	X	x	x	x
Missouri	X		x	x
Montana	X	x	x	x
Nebraska	x	x	x	X
Nevada	X		x	
New Hampshire	X		x	
New Jersey		X		
New Mexico			X	
New York	x	X		
North Carolina	X		x	
North Dakota	X	x		x
Ohio	X	x		x
Oklahoma	X	x	x	x
Oregon	X	x	x	x
Pennsylvania	X	x		
Rhode Island	x	X		
South Carolina	X	x		
South Dakota	x	X		
Tennessee	X	x	x	
Texas	x	x	X	x
Utah	x	X		
Vermont	X	x	x	
Virginia	X	x	x	
Washington	X		x	
West Virginia	X	x	x	
Wisconsin	x	X	x	
Wyoming	x	X	x	
Total Predominant	29	12	4	2
Note: The predominant approach is indicated by the large bold X . The smaller "x" indicates that a the state has incorporated features of the approach into their overall approach. A predominant approach is not indicated for states where it was not possible to identify which of multiple approaches was "predominant".				

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Alabama – The March 1999 NCSL compilation shows the predominant approach as program budgeting, while the 2002 NASBO report indicates elements of incremental budgeting and program budgeting.

Alaska – The NCSL table shows Alaska as a "traditional/incremental" state, which the legislative fiscal contact indicates is accurate given that the table shows the predominant approach. The NASBO table allows multiple responses, but neglects to indicate that Alaska recently adopted performance based budgeting as a tool to assist with our traditional approach. Further, while zero-based budgeting is not usual for us, the Governor has asked all departments to examine all programs to ensure they are consistent with the mission of the agency. It is not really zero-based budgeting, but something close.

Arizona – The budgeting model for Arizona is best described by NCSL's "traditional/incremental" category. According to the NCSL data, the state is required to convert to a program-based budget by fiscal 2006.

Arkansas – The state is using incremental budgeting for most agencies and performance budgeting for about 20 of its agencies.

California – Generally, traditional budgeting is used with program-based presentations, including allocations of funding and personnel by program area. The NCSL spreadsheet (traditional/incremental) is an accurate characterization of California's approach to budgeting. California has done some zero-based budgeting, but only on very limited basis (a couple of pilot programs).

Colorado – The state uses a combination of the budget approaches described as follows: "The General Assembly can require departments to submit zero-based budget requests. The General Assembly also has entered into performance-based memoranda of understanding with certain departments or agencies."

Connecticut – Although the budget is program-based and program measures are displayed in both the Governor's document and the Legislative Budget Report, much of the work on the budget is more traditional (major object, line item) than program-based.

Delaware – The state starts with a zero-based budget, but combines this with performance and traditional approaches.

Florida – The Florida contact reports that the information listed [on the NCSL and NASBO charts] is still current. They are, however, leaning toward combining program budgeting, zero-based budgeting and performance budgeting efforts. (According to the March 1999 NCSL compilation, Florida enacted requirements for performance-based budgeting that are being phased-in.)

Georgia – Beginning with the fiscal 2005 budget, Georgia will begin a "Prioritized Program Budget (PPB) process. For the past 30 years the annual budget requests of state agencies were called "Zero Based Budget Requests" however, these requests were nothing more than "Continuation Requests". In 1997 Governor Zell Miller installed a "redirection" process where agencies were required to cut or eliminate programs and "redirect" the funding to new or expanded programs. For information regarding (PPB) you can go to the Governor's Office of Planning and Budget web site and obtain the details of this process.

Hawaii – The March 1999 NCSL compilation shows the predominant approach as program budgeting, while the 2002 NASBO report indicates elements of incremental budgeting, performance-based budgeting, and program budgeting.

Idaho – The predominant approach is a program-based budget, but it also has elements of incremental, performance and zero based budgeting in the approach. The Idaho contact also provided the following that demonstrates the variations that occur in many states:

- *Our process is line-item to the extent that expenditure categories are defined in the appropriation bill; Personnel Costs, Operating Expenditures, Capital Outlay, and Trustee/Benefit Payments.*
- *Our process is incremental in that it accepts previous funding decisions in establishing a “base budget” on which to build for the coming year; and provides mechanisms to allow inflationary increases and program enhancements to existing programs.*
- *Our process is Program-based in that all budget information is structured by program with emphasis on goals and objectives by function.*
- *Our process is Performance-based in that performance measures are listed in the Legislative Budget Book and the state agency Strategic Plans are submitted with the Budget request documents.*
- *Our process has elements of a Zero-based approach through encouraging one-time expenditures and sun-setting of programs, zeroing those expenditures out of the budget base each year.*

Illinois – The budget is traditional with some aspects of program-based.

Indiana – According to the March 1999 NCSL compilation, budget instructions require some productivity data.

Iowa – The budget information [on the NCSL and NASBO charts] for Iowa is correct. Iowa has a combination approach. The departments begin with a 75 percent modified base budget (required by state law) at the program level. While performance measures are to be included at each level (Iowa has not successfully implemented performance based budgeting for most programs), they are reviewed during the budgeting process. The “75 percent modified base budget” is a variation of zero-based.

Kansas – According to the March 1999 NCSL compilation, although still largely based on traditional methods, performance measures are requested of agencies and reviewed by the Governor and legislature in formulating the budget.

Kentucky – Since 1997, Kentucky has not made an official change. However, the budget instructions for fiscal 2004-05 will definitely focus more on program and performance data at a much lower level than previous budgets. Kentucky is not doing" performance-based budgeting in that it has not set the standards and benchmarks on the front end but agencies are being asked to clearly define performance and indicators as a means for the General Assembly to go deeper in the budget requests (within the baseline) in making funding decisions.

Louisiana – According to the March 1999 NCSL compilation, Act 1465 of 1997 mandates performance budgeting.

Maine – According to the March 1999 NCSL compilation, statutory language calls for state government to fully implement performance budgeting for the 2000-2001 biennium. The Maine contact responded to survey request as follows: “Maine implemented performance budgeting for the 2002-2003 biennium. However, performance budgeting has been an "add-on" to Maine's traditional program and incremental

budgeting approach. Maine still builds its budgets incrementally and controls expenditures by appropriation to programs and line category (including positions authorized). Performance measures and goals and objectives have been added for each program. I would check all 3 columns when describing Maine's budgeting process.”

Maryland – According to the March 1999 NCSL compilation, the budget is organized into programs. Some attention is paid to performance measures, with a trend toward increased reliance on them.

Massachusetts – According to the March 1999 NCSL compilation, the legislative budget incorporates program-based budgeting and traditional budgetary analysis methods. A comprehensive overview of each agency's count of full-time employees, programs and their spending levels, and administrative spending is prepared by the Governor's Budget Bureau and the House and Senate Ways and Means Committee budget staff. The recent contact of legislative fiscal staff indicates that because of the recent fiscal crisis, Massachusetts has moved toward a zero-based budget approach. They review the budgets for every agency each year and do an evaluation of each program run by the agencies. They also ask if each program is actually necessary. In some cases, they start at zero and work their way up (or leave it at zero), but in other cases they know that funds must be expended (Medicaid, etc.) and look at what is absolutely necessary for a program to operate. The staff characterized the budget process as a combination of zero-based and program budgeting. It was also pointed out that Massachusetts has three agencies preparing a budget: the Governor's budget office, the House Ways and Means Committee and the Senate Ways and Means Committee. In the end, it is the House Ways and Means Committee that produces a conference report that becomes the budget. Opinions on their budget approach might vary among these agencies.

Michigan – According to the March 1999 NCSL compilation, the budget is performance-based, although appropriation bills contain objects of expenditure in some instances. However, legislative staff contacted recently indicates that Michigan uses an incremental type of budget process, saying that they did a little with performance measures about five years ago, but have completely abandoned this approach.

Minnesota – Minnesota follows a mostly traditional approach to budgeting but also blends in certain components of performance budgeting. Some state agencies have embraced the annualized reporting of key indicators (e.g. Education, Pollution Control Agency), while other agencies are still having difficulty with verifiable quantitative measures (Economic Security, portions of Human Services).

Mississippi – The State of Mississippi uses a combination of budgeting processes. This combination includes incremental budgeting, program budgeting, and performance measurement. In the fiscal 2004 budget, it used zero-based budgeting in the Personnel Services – Salaries category. It is using every means to generate a workable, while lean, budget for the state.

Missouri – The March 1999 NCSL compilation shows the predominant approach as incremental budgeting, while the 2002 NASBO report indicates elements of incremental budgeting, performance-based budgeting, and zero-based budgeting.

Montana – Montana's approach is primarily incremental but has at times incorporated (or attempted to incorporate) elements of the other approaches.

Nebraska – According to the March 1999 NCSL compilation, the appropriation structure is program-based. Requests are built in a traditional and modified zero-based structure. The 2002 NASBO report

indicates that the “budget approach utilized by the executive branch is strategic and places increasing emphasis on performance measures and results”, saying also that the legislature uses an incremental approach. The legislative fiscal staff contact indicates that a “modified zero-based structure to the requests is used on the legislative side of the fence.”

Nevada – Nevada's budget process is mostly based on the traditional/incremental model. An agency's fiscal 2002 expenditures represent the base budget in fiscal 2004. Certain adjustments are allowed in the base budget such as annualizing positions that were approved for only part of the fiscal year. A budget can have a number of "maintenance decision units" that are designed to allow the agency to provide the same level of service in the new fiscal year that was provided in the base fiscal year. Additional positions required to serve an increased number of clients would be an example of a maintenance unit. Any item that would enhance the level of service is contained in an enhancement decision unit within each budget account. For a number of years Nevada has included performance indicators for each account included in the budget document reviewed by the legislature. These indicators are reviewed by the legislature during the budget hearings and are utilized to determine how effectively the agency is accomplishing its objectives. While these indicators are utilized to measure how well an agency has performed, funding is not directly tied to how well an agency's performance indicators compare to the level that was initially projected.

New Hampshire – The primary budget approach is the traditional/incremental approach. New Hampshire has for the last six years tried to pilot a performance based budgeting approach for four programs with the hope of expanding into other areas but this experiment is not gaining any traction and is unlikely to continue much longer.

New Jersey – According to the March 1999 NCSL compilation, the state has a program-based budget, but it is constructed and displayed by department. Although there are several summary pages showing program allocations across organizational lines, most of the budget is structured organizationally. Also, the budget still displays allocations by spending object (e.g., salaries, materials and supplies, etc.) as well as by program.

New Mexico – New Mexico started to move from traditional incrementing budgeting to performance-based budgeting about five years ago. The change was established in law under the title of Accountability in Government Act. The change was phased-in over four years. So, it is now fair to say that the predominant form of budgeting is performance-based. The general appropriation act allocates money to state agencies by program. The act includes language describing the purpose of the program. It makes program appropriations three categories: personal services and benefits, contractual services, and a catchall category called other. Performance measures are attached to each program. New Mexico tries to have a balanced set of measures, including outcome, output, quality and efficiency measures.

New York – The March 1999 NCSL compilation shows the predominant approach as program budgeting, while the 2002 NASBO report indicates elements of incremental budgeting and program budgeting.

North Carolina – The state has reverted to the traditional "incremental" budgeting approach. The Governor submitted his fiscal 2003-05 budget in the traditional line item style. The state's performance based budgeting statute has been repealed. While the Governor does not submit a full performance based budget document, the executive budget document still contains some performance information. The General Assembly also establishes performance measures for specific programs as it sees fit.

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North Dakota – North Dakota has basically a traditional/incremental approach to budgeting. However, the Governor usually, in recent years, has required agencies to submit a budget at 95 or 98 percent of the previous biennium spending. Any increase must be offset by a reduction to live within the limit. Several agencies have a program budget, but it is generally funded, as are other agencies, on an incremental approach.

Ohio – According to the March 1999 NCSL compilation, Ohio's primary approach from the legislature's point of view, is the "traditional/incremental" approach. The 2002 NASBO report indicates a "modified zero-based and program budgeting" approach. In the latter, the Governor has agencies submit a budget with a base of 90 percent (85 percent for most recent budget) and then requires agencies to justify increases from that level.

Oklahoma – The primary approach is the traditional/incremental budgeting. Oklahoma used and repealed "zero-based budgeting" in the late 1980's after it proved to be useless in cutting budgets. Some of the concepts have remained in the process. Likewise program budgeting was adopted in the 1994 but largely disregarded as time went by, although many concepts remain in the budget system. The House has used performance-based analyses for about four years. This year the Legislature adopted a new system based upon the performance based concepts used by the House and zero based analyses.

Oregon – Budgeting is predominantly traditional, but also has elements of performance-based (application of benchmarks), program-based (sub agency level or program identification) and zero-based (includes discussion of 10 percent to 20 percent reduction packages).

Pennsylvania – Pennsylvania has more of a combination process. Years ago, in Pennsylvania there was more discussion of a program budget, but that has evolved over time to more of an incremental approach. The Governor's budget document still takes a program approach, but the legislature generally follows a line item format in the appropriations bill. The 2002 NASBO report indicates that the budget office uses a modified zero-based and program budgeting approach, and it is working to incorporate performance measures into budgeting.

Rhode Island – The March 1999 NCSL compilation shows the predominant approach as program budgeting, while the 2002 NASBO report indicates elements of incremental budgeting and program budgeting. From the Rhode Island budget office website, "the Rhode Island budget employs a program budget format. *A program is a collection of similar activities and services directed toward a defined purpose or goal and managed by a single identifiable authority*".

South Carolina – According to the March 1999 NCSL compilation, the House Ways and Means Committee is placing greater emphasis on agency accountability reports for fiscal 1996-97 in developing budget recommendations for fiscal 1998-99, which is consistent with elements of a performance-based or program budgeting approach. No further information is available.

South Dakota – South Dakota appropriates money on an "incremental program" basis, according to the chief legislative fiscal analyst. The March 1999 NCSL compilation shows the predominant approach as program budgeting, while the 2002 NASBO report indicates elements of incremental budgeting and program budgeting.

Tennessee - According to the March 1999 NCSL compilation, budgeting is defined in statute as zero-based. However, the state practices a continuation of required programs plus essential improvements

[which is interpreted to be more of a traditional/incremental approach. Tennessee is currently in the pilot stages of performance budgeting with three departments due to roll out in the '04 budget.

Texas – The Texas budget system is performance-based in structure. Every two years state agencies submit 6-year strategic plans with goals, objectives, strategies, and four different types of performance measures (outcome, output, efficiency, and explanatory). Then agencies request appropriations for the first two years of their strategic plan. Strategies in the strategic plan become items of appropriation in the general appropriations act. In practice, the budget system also has characteristics of the incremental and program approaches. Texas uses a base period (e.g., 02-03 biennium) when considering appropriations for the next biennium (e.g., 04-05). Some agencies align their strategic plans along the lines of major programs, and legislators over the years have asked that certain programs be made into a single strategy so they are visible to members and the public. Finally, the budget crunch was so significant this past session that agencies were asked to re-submit their budget requests from the bottom (zero) up. So Texas got a little zero-based budgeting mixed in as well this time.

Utah – The March 1999 NCSL compilation shows the predominant approach as program budgeting, while the 2002 NASBO report indicates elements of incremental budgeting and program budgeting.

Vermont – According to the March 1999 NCSL compilation, Vermont uses a combination of traditional and performance-based budgeting. The 2002 NASBO compilation shows incremental and program budgeting.

Virginia – Virginia's budgeting system is a combination of program, incremental and performance budgeting. There really is very little zero-based budgeting, other than zeroing out all grants for historic landmarks and non-state agencies and special one-time appropriations, from the base budget before the process of building the next budget begins. The proposed executive budget begins with the calculation of a two-year, biennial base budget, which is equal to the adjusted appropriation for the base year, multiplied by two. For example, if the adjusted appropriation for fiscal 2004 were \$10 billion (including all of the necessary adjustments to annualize partial-year expenditures and to eliminate one-time or non-recurring expenditures), then the base budget for the 2004-06 biennium would be \$20 billion (i.e., \$10 billion times two). This extrapolation is simply a technical way to project how much it will cost in the next two years to continue exactly what the state was spending in the current or base year. Anything new, such as the increased cost of meeting public education standards, new programs or changed services, additional employees, or a salary increase for current state employees, for example, would have to be added on to the base budget.

Washington – According to the March 1999 NCSL compilation, Washington's primarily uses a traditional/incremental budgeting approach. The 2002 NASBO compilation shows incremental and performance-based budgeting.

West Virginia – According to the March 1999 NCSL compilation, the starting point in considering the request for the next fiscal year is the current level of funding and the additional money necessary to maintain the current level after factoring in inflation, etc. Performance measures are agency or department matters, and programs are ranked within agencies or departments in order of importance. There is little discussion in legislative hearings about these matters. The emphasis is on current levels and whether funds are available to enhance programs or add projects or programs.

Wisconsin – The March 1999 NCSL compilation shows the predominant approach as program budgeting, while the 2002 NASBO report indicates elements of incremental budgeting, program budgeting, and performance-based.

Wyoming - The March 1999 NCSL compilation shows the predominant approach as program budgeting, while the 2002 NASBO report indicates elements of incremental budgeting, program budgeting, and performance-based.

SUMMARY

There are four especially notable approaches to budgeting that the various states apply in one form or another. They are: 1) traditional/incremental budgeting; 2) program-based budgeting; 3) performance-based budgeting; and 4) zero-based budgeting. Montana uses the traditional/incremental approach as does a large majority of the states. Most these states, including Montana, have incorporated features of the other approaches in an attempt to take advantage of some of the benefits of those methods of budgeting without the drawbacks of those approaches. Some states have made one or more of the other budgeting approaches their predominant approach, but they too have incorporated features from others. It appears that no state has wanted to implement any of the four approaches in their purest form. The evolution of budget systems in the various states seems to illustrate that hybrids of the budget models have the best success stories, and that state budget systems continue to evolve based upon the fiscal condition and the political climate in which they exist.

In closing, this report has attempted to describe the current status of budgeting in Montana and in the other states. The next step in this study could be to determine the “best practice” budget process for Montana. Further examination of the Montana approach and the success stories of other states might lead to some proposed changes for the budget cycle that begins in the winter and spring of 2004, or to proposed legislation that recommends reforms that could be applied in subsequent budget cycles.

Appendix

Excerpt from “Fundamentals of Sound State Budgeting Practices” NCSL May 1995

THE CHALLENGE TO TRADITIONAL STATE BUDGETING

This report begins with a discussion of alternative ways of thinking about and writing state budgets. Traditional state budgeting is under attack on the grounds that its processes are fundamentally flawed. Critics charge that current budgeting practices discourage examining program outcomes in favor of automatically continuing of existing programs, discourage policy analysis in favor of legislative micromanagement, and are too tolerant of bureaucracy and waste. They allege that budgets fail in their mission of reviewing the past and planning for the future.

Chapter 1 looks at these issues:

- Traditional methods of state budgeting
- Performance-based budgeting
- Zero-base budgeting
- Why traditional budgeting survives

Budget processes always benefit from reconsideration because, at the very least, reconsideration improves people’s understanding of the difficulty of the process. This chapter contends that changes in budgeting processes will not achieve the desired goals if too much is expected of them. That is not an argument against change. It is a caution against jumping on bandwagons.

TRADITIONAL METHODS OF STATE BUDGETING

Participants and observers agree that state budgeting is less satisfactory, in process and in outcome, than in previous years. Hard times always make for hard budgets, but many feel that in recent years, the process itself has been to blame, particularly because of its traditional focus on line-item control and incremental budgeting.

Traditionally, state budgets have focused on controlling expenditure. Control is expressed in written budgets through “line items” – statements allocating so much money for a specific expense: computers for the tax collectors, acquisitions for the state library, salaries for prison guards. Where written budgets focus on line items, legislators tend to do so as well.

Line-item budgeting tends to be incremental—previous appropriations are increased or decreased by small increments over time. This approach is likely to take previous policies and programs for granted, and discourage rigorous or fundamental review of priorities, program effectiveness, or service outcomes.

These practices are under attack because they are said to foster a business-as-usual approach to government at a time when the public is challenging how state governments operate, questioning their efficiency and effectiveness, and expressing distrust of representative government itself.

Line items focus on what money buys (an input) rather than on the service that is provided (an outcome). An input could be tons of asphalt for state highways or new computers for property tax assessors. Outcomes are less likely to be considered:

Have traffic conditions improved enough to justify the asphalt? Are property tax assessments more timely and equitable? Nothing in a line-item budget prevents such questions from being asked, but the format does not encourage questions because the written form of budgets tends to drive the way people think about them.

With growing concern about how well government functions, many people contend that the traditional focus on line-item budgeting and incremental change neglects outcomes so much that the budgeting process itself is an impediment to effectively delivering programs. Critics contend that *line-item budgeting does not do enough to take program results into account*. Two questions arise: Are these criticisms justified? Can adopting of a different technique improve budget outcomes? This chapter first looks at two proposals for reforming budget processes—performance-based budgeting and zero-base budgeting. Then it returns to the evaluation of traditional incremental budgeting.

PERFORMANCE-BASED BUDGETING

Governors and legislators throughout the states are revising budget procedures to emphasize performance and results. This activity goes under many names: outcome-based budgeting, performance budgeting, and sometimes program budgeting. The terms are confusing because in current use they overlap but do not mean exactly the same things. In general, though, the present trend is to reshape budgeting processes to reward efficient, effective programs and to encourage remodeling programs that cannot meet specific goals. In this report, this kind of budgeting is called *performance-based budgeting*.

Performance-based budgeting calls for a revolution in how states are governed. It focuses on setting goals, designing the strategies needed to meet the goals, and measuring how well they are met. Future funding decisions should focus on program effectiveness, not on the preservation of existing programs and levels of spending. This approach requires that budgeting be directed at programs rather than at specific line items, that the goals of those programs be laid out in measurable terms, and that performance review becomes central to budget decisions.

None of this is easy:

- It is hard to identify and reach agreement on quantifiable goals for most state programs. For example, in the ambitious performance-based budget that Governor William F. Weld of Massachusetts developed for fiscal year 1994, the agency and program mission statements explain what the agencies do rather than set goals.
- Any reasonable definition of state programs has to recognize that many of them cross existing agency lines, so that full implementation of a program-oriented performance budget might require extensive reorganization. The Legislative Analyst in California has in fact suggested that effective program management will require restructuring the division of responsibilities between state and local government, which would require constitutional changes.

Advocates contend that the difficulty of implementing a performance-based budget is evidence of how thoroughly state government needs to be reformed. They say that the difficulty of agreeing on goals for programs is evidence that the issue has been neglected, and the process of trying to reach agreement will

produce valuable analysis and debate. If existing agency structures impede a focus on programs and service delivery, the framework needs rebuilding. The difficulty of measuring performance has to be faced squarely. How else can anyone know whether government is providing needed services? How else can public confidence in government be rebuilt?

Massachusetts Governor Weld submitted his budget proposals for fiscal year 1994 in the form of a performance-based budget, in many ways providing a working model of the general purposes of such reform. His budget proposals and the appropriations bill he submitted to the legislature are organized by agency programs, without line items below the program level.

All programs—*service delivery groups* in Governor Weld's idiom—developed performance measures including such categories as the amount of service provided, productivity, degree of public satisfaction, equity of service delivery, and the extent to which a program met its immediate purpose. The budget followed up this logic by proposing great authority for agency managers to transfer funds from one program to another under their control. Massachusetts legislators were unwilling to adopt much of Weld's restructuring of the budget, in part because it would have increased executive authority at the expense of the legislature.

Texas legislators have adopted a performance-based budget, and in Texas' case, the Legislature so thoroughly dominates the budget process that there is little likelihood of any increase in executive control. The budget for the current biennium required six-year strategic plans from state agencies and provided funding according to the agencies' goals and objectives.

There is widespread enthusiasm for performance budgeting in the state, and some states have implemented some elements, especially the goal-setting and the great attention to performance measurement. Questions remain:

- What will a state legislature do if a program does not reach its targeted goals?
- How can rewards for performance be established without creating incentives to reshape programs to reap rewards rather than improve programs?
- How willing are legislators to trade certain control over budget detail for promises of improved service delivery that require great executive discretionary power?

ZERO-BASE BUDGETING

The popularity of zero-base budgeting (ZBB) is partly due to its name. It appeals to many people who are concerned with public budgeting because, according to one standard definition, it requires "the review of all budget requests from point zero, without assuming that any existing program should continue." Although the original goals of ZBB have proved elusive, in a modified form it has become a widely used budgeting tool.

In its original sense, ZBB meant that no past decisions are taken for granted. Every previous budget decision is up for review. Existing and proposed programs are on an equal footing, and the traditional state practice of altering almost all existing budget lines by small amounts every year or two would be swept away. No state government has ever found this feasible. Even Georgia, where Governor Jimmy Carter introduced ZBB to state budgeting in 1971, employed a much modified form.

State programs are not, in practice, amenable to such a radical annual re-examination. Statutes, obligations to local governments, requirements of the federal government, and other past decisions have many times created state funding commitments that are almost impossible to change very much in the short run. Education funding levels are determined in many states partly by state and federal judicial decisions and state constitutional provisions, as well as by statutes. Federal mandates require that state Medicaid funding meet a specific minimum level if Medicaid is to exist at all in a state. Federal law affects environmental program spending, and both state and federal courts help determine state spending on prisons. Much state spending, therefore, cannot usefully be subjected to the kind of fundamental re-examination that ZBB in its original form envisions.

As practice in state government, ZBB has been used to consider reducing activities in a program, not just to look at its continuation or expansion. It does so by requiring that

- Agencies' formal budget requests include the consequences of different funding levels; and that
- Activities be prioritized according to the possibility of increased and decreased funding for each of them.

ZBB appeared in the 1970s when rapid growth in federal programs, grant-in-aid to states, and state tax sources seemed to be bringing inexorable and unexamined growth to state budgets. Hence it focused on potential restraint and possible cuts, rather than on the quality of service delivery. The first two states to adopt ZBB enthusiastically were Georgia and Texas, both of which were at the time experiencing economic booms and above-average expenditure growth rates.

In the states where it continues to exist in some form, ZBB is hard to separate from the widespread practice of expecting agencies to evaluate the impact of changes in funding on operations. This is a useful technique. It provides valuable information both when state resources are expanding and when cuts are needed, and assists policymakers to break with the tradition of incrementalism. Even more important in the budget climate of recent years, the process makes it possible to avoid across-the-board cuts by emphasizing the effects of different cuts on services.

To the extent that ZBB has encouraged governors and legislators to take a hard look at the impact of incremental changes in state spending, it produced a significant improvement in state budgeting. But in its classic form—begin all budget evaluation from zero—ZBB is as unworkable as it ever was.

WHY TRADITIONAL BUDGETING SURVIVES

Why is it so hard to change traditional budgeting methods? Why does budget reform seem to excite more interest than activity? Critics of proposed reforms suggest two reasons:

- Traditional budgeting meets more expectations about the process better than any proposed reform, and
- Reforms will not solve the problems that reformers have identified.

Proposals for reform focus on particular unsatisfactory results from the existing process and recommend ways to improve those results. But they may fail to consider how many conflicting expectations the budget process has to meet. Aaron Wildavsky, an expert on government budgeting methods, puts it like this:

Budgeting is supposed to contribute to continuity (for planning), to change (for policy evaluation), to flexibility (for the economy), to rigidity (for limiting spending), and to openness (for accountability).

Wildavsky goes on to suggest that a budget process that is expected to do so many disparate things will work worse as more specific formulas and expectations are loaded onto it. Budgeting, he argues, should not be made responsible for all of the aims of government. Traditional budgeting has responded fairly well to the conflicting demands made upon it because it builds upon previous agreements and commitments. It does not reopen every question and it does not try to do too much. Planning, evaluating, and accounting are activities that can proceed effectively without being central to the budget. For budget processes not to be overloaded, they should continue to focus on narrow, not broad, purposes.

Hal Hovey, editor of *State Policy Reports* and a close observer of state reform, concurs, writing recently in *The Fiscal Letter*:

Many of the values of reforms can be lost by expecting too much from them. They won't ever solve the real problem, which is that we voters want to spend more than we want to pay in taxes, and insist on elected officials who agree with us. We are all in for trouble if state officials do what the Congress has made a practice of doing—substituting a new round of budget reforms for dealing with the budget.

Both Wildavsky and Hovey are suggesting that traditional budgeting survives because of its lack of rigorous method. The traditional system allows but does not require legislators and governors to use many techniques and kinds of information now available and similar to those which reformers urge them to adopt. Program and financial auditing, performance evaluation teams, and short- and long-term forecasting already are institutional fixtures of many state governments. Sunset review processes also exist in many states. There is no lack of review. What is lacking, according to legislators and the staff who provide the audits and reviews, is the use of the information in budgeting.

Much good information goes unused because legislators sometimes find program reviews and audits focused on the wrong question, too detailed, or untimely. Some issues can be addressed with better communication between legislators and evaluators. A more significant reason is time itself: Legislators lack the time to make use of all the information that is available to them. The lack of rigorous method in traditional budget processes allows legislators to focus on their priorities to the exclusion of others, work on what is most important at the time, and rely on the continuation of past decisions in other areas. This flexibility is the greatest strength of traditional budgeting methods.

The following is an excerpt from a National Conference of State Legislatures (NCSL) publication titled *Legislating for Results*, published in December 2003.

HOW USING PERFORMANCE INFORMATION CAN HELP YOU

Performance information, especially outcome information, provides information about the results the state is obtaining for the activities it undertakes and for the funds it spends. The information provides a major accountability tool. Perhaps even more important, it provides basic information to help improve what the state is doing for its citizens.

More specifically, here is what legislating for results can do you:

In Hearings:

- Enable legislators to ask state agencies the right questions about their responsibilities-about both past performance and expected future results.
- Encourage program management to recognize the need to focus on results and the program's accountability for results.
- Indicate that the legislature is serious about considering service outcomes.
- Provide useful information about state programs that can be communicated easily and clearly to constituents.
- Enable legislators to ask meaningful questions about politically sensitive programs without being misinterpreted as opposition. For example, a legislator might ask, "Has the domestic violence program actually helped reduce domestic violence? From what level to what improved level?" rather than simply asking whether the program's provisions of shelter to victimized women is less important than direct prevention activities.

To Help Make Appropriation and Policy Decisions:

- Help identify areas for potential budget reductions, increases or reallocations, including identifying the estimated consequences of such changes.
- Provide a clearer link between appropriations and actual services provided.
- Identify programs and agencies that are seeking similar outcomes, thereby drawing such inter-relationships to the legislature's attention. Such situations create a need for coordination and sorting out the activities and responsibilities. Common goals and responsibilities then can be addressed.
- Improve oversight of state programs and policies.

To Provide Knowledge to Inform Policy Development and Improve Communication with Constituents:

- Provide objective evidence on outcomes of agency activities that inform the political debate.
- Assist legislators to develop policies by providing objective information about current conditions.
- Enhance state strategic planning efforts by encouraging a long-term focus on results (i.e., outcomes of government efforts).
- Provide legislators with objective information with which to address constituents' questions and concerns.

Attachment B

- Provide information directly related to constituent concerns (citizen-focused outcomes), enabling improved constituent service and increasing citizen confidence that the legislature is addressing citizen concerns.

To Change the Approach to Service Delivery:

- Push state employees to focus on the goals and desired outcomes of their programs.
- Make clear which programs work and which ones do not.
- Improve decisions about whether to "privatize" a service or return a privatized service to state administration by providing information about both the past quality and the costs of the service.

What Performance Information Cannot Do:

- Tell you exactly the contribution of the state agency activity to the outcomes that occur. Legislative actions such as those described in briefs 7, 9 and 10 can provide explanations (reasons) for high or low levels of performance. However, performance information by itself cannot identify which factors caused the outcomes that occurred and to what extent each factor contributed.
- Similarly, performance information seldom identifies specific actions that are needed to correct problems. The performance information, however, can provide useful clues about what needs to be done and where.